

CERTIFICATION OF ADMINISTRATIVE RULE
FILED WITH THE SECRETARY OF STATE
KAREN HANDEL

(Pursuant to O.C.G.A., §§ 50-13-3, 50-13-4 and 50-13-6.)

I do hereby certify that the attached new Rule is a true and correct copy as promulgated and adopted on the 8th day of June, 2009.

DEPARTMENT OF REVENUE

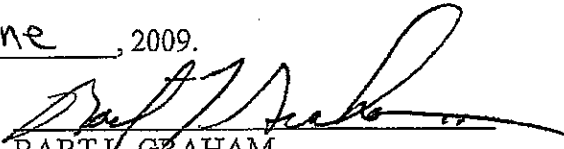
FILED June 8, 2009

Rule 560-7-3-.05, entitled "Related Member Interest Expenses and Costs; and Intangible Expenses and Costs" is hereby adopted and reads as the copy attached hereto.

STATUTORY RULE MAKING AUTHORITY:

O.C.G.A. §§ 48-2-12 and 48-7-28.3

This 8th day of June, 2009.


BART L. GRAHAM
STATE REVENUE COMMISSIONER

Sworn to and subscribed
before me this 8th day of June, 2009.


NOTARY PUBLIC

Notary Public, Rockdale County, Georgia
My Commission Expires Nov. 19, 2012

**RULES
OF
DEPARTMENT OF REVENUE
INCOME TAX DIVISION**

**Chapter 560-7-3
SUBSTANTIVE REGULATIONS**

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560-7-3-.05 Related Member Interest Expenses and Costs; and Intangible Expenses and Costs.

560-7-3-.05 Related Member Interest Expenses and Costs; and Intangible Expenses and Costs.

(1) **Purpose.** The purpose of this regulation is to provide guidance with regard to the administration of O.C.G.A. § 48-7-28.3, which requires the taxpayer to add back certain related member interest expenses and costs, and intangible expenses and costs. For purposes of this regulation, such expenses shall be referred to as related member costs.

(2) **General Guidelines.** The Department requires all direct and indirect related member costs to be added back to income prior to claiming an exception to the addback adjustment. Any person that paid, accrued, or incurred such related member costs must complete Form IT-Addback.

(3) **Direct and Indirect Expenses.** If an expense that is paid, accrued, or incurred by one related member is related, directly or indirectly, to a related member cost paid, accrued, or incurred, directly or indirectly, by or for any other related member, it is an

indirect related member cost and as such is required to be added back as provided in O.C.G.A. § 48-7-28.3. For example:

(a) Corporations B and C are related members with respect to Corporation A. Corporation A is a Georgia taxpayer that purchases products from Corporation B. Corporation B licenses intangible property from Corporation C and as such makes related member cost payments to Corporation C. To the extent the related member costs which Corporation B pays to Corporation C are directly or indirectly included in the costs of the products or services Corporation A purchases from Corporation B, the direct related member costs of Corporation B are considered to be indirect related member costs of Corporation A. As such, for purposes of O.C.G.A. § 48-7-28.3, Corporation A is deemed to indirectly pay related member costs to Corporation C that are subject to the addback adjustment.

(b) Corporations B and C are related members with respect to Corporation A. Corporation A is a Georgia taxpayer that pays a management fee to Corporation B. Corporation B licenses intangible property from Corporation C and as such makes related member cost payments to Corporation C. To the extent the related member costs which Corporation B pays to Corporation C are directly or indirectly included in the costs of the management services Corporation A purchases from Corporation B, the direct related member costs of Corporation B are considered to be indirect related member costs of Corporation A. As such, for purposes of O.C.G.A. § 48-7-28.3, Corporation A is deemed to indirectly pay related member costs to Corporation C that are subject to the addback adjustment.

(c) Corporation B is a related member with respect to Corporation A. Corporation A acquires intangible property from Corporation B, thus giving Corporation A a cost basis in the

intangible property. The related amortization amount that may be permitted as a deduction pursuant to Internal Revenue Code § 197 would constitute a recovery of “costs directly or indirectly for, related to, or in connection with the direct or indirect acquisition [or] ... ownership ... of intangible property,” as defined in O.C.G.A. § 48-7-28.3(a)(4). Such amortization expense would therefore be considered an indirect related member cost of Corporation A subject to the addback adjustment.

(4) Authority to Reverse Adjustment. Subsection (c) of O.C.G.A. § 48-7-28.3 provides that the Commissioner shall have the authority to reverse in whole or in part the adjustments required by subsection (b) of O.C.G.A. § 48-7-28.3 when the taxpayer and the Commissioner agree in writing to the application or use of an alternative method of apportionment under subparagraph (d)(2)(C) of O.C.G.A. § 48-7-31 (this subparagraph was redesignated from (E) to (C) effective January 1, 2008), O.C.G.A. § 48-7-35, or O.C.G.A. § 48-7-31.1. Except with respect to O.C.G.A. § 48-7-31.1, taxpayers that wish to request such permission from the Commissioner shall file an application, petition, or request with the Commissioner at least ninety (90) days prior to the due date of the Georgia return (including extensions) or at least ninety (90) days prior to the filing of the return, whichever occurs first, for the tax year for which such application or use of an alternative method of apportionment is requested. Failure to request permission by such time will result in the filing of income tax returns subject to the regular apportionment methods for the applicable tax year. Except with respect to O.C.G.A. § 48-7-31.1, the reversal of the adjustment shall be applied:

(a) Only in those cases where unusual fact patterns occur that are unique and which will produce incongruous results based upon standard allocation and apportionment provisions; and

(b) Only when the taxpayer establishes by clear and convincing evidence that the taxpayer's proposed allocation and apportionment method would more clearly reflect the income attributable to the trade or business within Georgia.

(5) Exception for Income Allocated or Apportioned to and Taxed by Georgia or Another State. The various factors of the exception for income allocated or apportioned to and taxed by Georgia or another state are set forth below:

(a) Subsection (d) of O.C.G.A. § 48-7-28.3 provides that the adjustment required by subsection (b) of O.C.G.A. § 48-7-28.3 shall be reduced, but not below zero, to the extent the corresponding related member costs are received as income in an arm's length transaction, as defined below in subparagraph (5)(d) 5.i., by the related member and the amount to be included in the income base is allocated or apportioned, or both, to and taxed by Georgia or another state that imposes a tax on or measured by the income of the related member. For example:

1. A taxpayer doing business in Georgia expenses \$5,000,000 in related member costs. The related member files a return in State A. The related member's apportionment ratio in State A is 75%. Applying the apportionment ratio to the income of the related member results in \$3,750,000 of the related member's income being apportioned to and taxed in State A. Subtracting the \$3,750,000 from the \$5,000,000 results in the taxpayer making an addback adjustment for Georgia purposes of \$1,250,000.

2. A taxpayer doing business in Georgia expenses \$5,000,000 in related member costs. The related member files a return in State B. The related member's apportionment ratio in State B is 75%. However, the related member has expenses of \$500,000 that reduce the income to \$4,500,000. The taxpayer is not required to

subtract the \$500,000 expense from the \$5,000,000 to determine the Georgia addback adjustment. Applying the apportionment ratio to the income of \$5,000,000 results in \$3,750,000 of the related member's income being apportioned to and taxed in State B. Subtracting the \$3,750,000 from the \$5,000,000 results in the taxpayer making an addback adjustment for Georgia purposes of \$1,250,000.

3. A taxpayer doing business in Georgia expenses \$5,000,000 in related member costs. The related member does not file returns in any state. However, the taxpayer is required by State C to adjust their income for such related member costs. Assume this results in the taxpayer decreasing their expense in State C by \$2,500,000. Since it is the taxpayer itself and not the related member that is being taxed by State C, the addback adjustment for Georgia purposes is not reduced and is equal to \$5,000,000.

(b) If the related member's net income is eliminated or reduced or its tax liability is offset by a credit or similar adjustment that is dependent upon the related member either maintaining or managing intangible property or collecting interest income in that jurisdiction, such income shall not be considered to be taxed to the extent of such reduction of income or to the extent of the income corresponding to the reduction in tax liability. For example:

1. A taxpayer doing business in Georgia expenses \$5,000,000 in related member costs. The related member files a return in State D. The related member's apportionment ratio in State D is 75%. However, the related member's income is reduced by State D because the related member manages intangible property in State D and state D confers a credit or similar adjustment upon corporations that own or manage intangible property in that state. This credit or adjustment reduces the income of the related member that is actually taxed by \$2,000,000 to \$3,000,000.

Applying the apportionment ratio (75%) to the reduced income of \$3,000,000, results in \$2,250,000 of the related member's income being apportioned to and taxed in State D. Subtracting the \$2,250,000 from the \$5,000,000 results in the taxpayer making an addback adjustment for Georgia purposes of \$2,750,000.

(c) To the extent a taxpayer is deemed to indirectly pay related member costs as provided in paragraph (3), the taxpayer shall be eligible for this exception only to the extent such related member costs received by any other related member(s) meets the requirements of this exception. For example: Assume the same facts as those in the example in subparagraph (3)(a). The exception would only be available if the related member costs deemed to be paid by Corporation A to Corporation C are received as income in an arm's length transaction by Corporation C and such income is allocated or apportioned, or both, to and taxed by Georgia or another state that imposes a tax on or measured by the income of Corporation C.

(d) When a taxpayer seeks to claim the exception provided by subsection (d) of O.C.G.A. § 48-7-28.3, the taxpayer must attach a copy of Form IT-Addback and any applicable schedules to its tax return and provide the following information on the Form IT-Addback (with all supporting documentation to be made available upon request):

1. The name and federal identification number of the related member(s);
2. The name of each state and type of tax paid;
3. The amount of the related member costs;

4. The amount of related member costs subject to apportionment and/or allocation, the apportionment ratio, and the amount of income apportioned after applying the ratio for each state for such related member;

5. A brief description of the arm's length status of the transactions between the taxpayer and the related member. However, a more detailed description needs to be made available upon request or upon audit. The following shall apply with respect to such detailed description:

(i) The taxpayer must establish and substantiate by a preponderance of evidence that the amount of the cost or expense in question was substantially identical to what would be expended in an arm's length transaction under substantially similar circumstances. "Arm's length" is the amount of consideration that would be paid or received in a transaction between unrelated persons, whereby neither person is under any compulsion to enter into the transaction and each person has reasonable knowledge of all relevant facts. This arm's length standard is also met if the results of a transaction are consistent with the results unrelated taxpayers would have had if they had engaged in the same transaction under the same circumstances;

(ii) For purposes of substantiating that the amount of such expense(s) was at arm's length, a taxpayer who is relying upon an appraisal or a study must identify and make available upon request such appraisal or study and provide the name of the preparer thereof, and state the date on which such appraisal or study was issued and the general conclusions thereof;

(iii) In general, the Commissioner will be more likely to allow an exception when the two related members are not controlled or managed on a day-to-day basis by the same person(s) and the same

person(s) did not occupy both sides of the bargaining table. This will be particularly so when the two related members were previously independent entities or, if not previously independent, function like independent entities without interconnected activities or overlapping interests. The taxpayer must note whether the taxpayer believes that the transaction was in fact negotiated by related members who were dealing with each other on an arm's length basis. At the same time, the Commissioner recognizes that in many controlled-group contexts, related members will not in fact conduct arm's length negotiations. If the terms of an agreement between related members are substantially the same as those that unrelated parties would have entered into, the fact that the overall organization of which the related members form a part is centrally managed will not, by itself, preclude relief from the addback provisions;

(iv) The taxpayer must explain and clarify in detail how the related member obtained the intangibles in question, such as whether the intangibles were either developed by the related member that receives the payment or were purchased by the related member in a bona fide arm's length sales transaction; and

(v) Where a taxpayer cannot show by a preponderance of evidence that the amount of the deduction was at arm's length, the Commissioner may adjust the cost or expense to reflect arm's length pricing or, alternatively, may deny the taxpayer's exception claim in its entirety; and

6. Such other information as the Commissioner may prescribe.

(6) Exception for Expenses Paid, Accrued, or Incurred to a Related Member Domiciled in a Foreign Country. The following provides for the exception for expenses paid, accrued, or incurred to a related member domiciled in a foreign country:

(a) Subsection (e) of O.C.G.A. § 48-7-28.3 provides that the adjustment required by subsection (b) of O.C.G.A. § 48-7-28.3 shall be reduced, but not below zero, if and to the extent:

1. The related member costs are paid, accrued, or incurred to a related member domiciled in a foreign nation which has in force a comprehensive income tax treaty with the United States;
2. The transaction giving rise to the related member costs has a valid business purpose; and
3. The amounts of such related member costs were determined at arm's length rates.

(b) When a taxpayer seeks to claim the exception provided by subsection (e) of O.C.G.A. § 48-7-28.3, the taxpayer must provide the following information on the Form IT-Addback (with all supporting documentation to be made available upon request or upon audit):

1. The name and federal identification number of the related member;
2. The amount of the related member costs;
3. The country of domicile of the related member;
4. A description of the comprehensive income tax treaty;
5. A description of the business purpose of the transactions between the taxpayer and the related member. The following shall apply with respect to such description:

(i) The taxpayer's business purpose or purposes for its transaction must be stated in specific terms and not in the abstract. Also, the purpose or purposes stated should relate to the particular transaction(s) for which the deduction is being claimed and not, for example, to the formation of the related member entity that takes part in the transaction. Further, the taxpayer's business purpose or purposes should be related to business activity that is conducted by the taxpayer or business activity that the taxpayer is planning to conduct;

(ii) The taxpayer must identify each of the elements of the transaction(s) that it relies upon to support a finding that the activity or transaction changes in a meaningful way, apart from the tax effects, the economic position of the taxpayer. If the taxpayer entered into the transaction on the advice of a tax advisor, or the terms of the engagement with a tax advisor determined the fee paid directly or indirectly to the advisor by reference to the actual or anticipated tax savings derived from the transaction, the taxpayer must disclose such fact(s); and

(iii) A statement as to whether the payments in either case were made pursuant to one or more written agreements and if so must briefly describe each agreement. Further, the taxpayer must state how the taxpayer actually used the intangible property in question;

6. A description of the arm's length status of the transactions between the taxpayer and the related member. The provisions listed in subparagraph (5)(d)5. shall apply with respect to such description; and

7. Such other information as the Commissioner may prescribe.

(c) For example: Corporation A, a foreign corporation, domiciled in a jurisdiction that has entered into a comprehensive

income tax treaty with the United States of America, owns directly or indirectly 100 percent of the outstanding shares of three U.S. domestic subsidiaries (Corporation B, Corporation C, and Corporation D). Corporation B and Corporation C utilize certain technology developed by Corporation A in their daily operations of manufacturing products for resale. Corporation D was formed to hold and does hold the U.S. rights to such technologies developed by Corporation A. Corporation B and Corporation C pay a royalty to Corporation D for the ability to use the technology developed by Corporation A in its daily operations. Corporation D pays an annual royalty to Corporation A based on the amount of royalties it receives from Corporation B and Corporation C. Amounts paid to Corporation D by Corporation B and Corporation C would be eligible for the exception provided they otherwise qualify. Also the amounts paid by Corporation D to Corporation A would be eligible for the exception provided they otherwise qualify.

(7) Exception for Expenses to a Related Member who Paid, Accrued, or Incurred Expenses to a Person who is not a Related Member. The following provides for the exception for expenses to a related member who paid, accrued, or incurred expenses to a person who is not a related member:

(a) Subsection (f) of O.C.G.A. § 48-7-28.3 provides that the adjustment required by subsection (b) of O.C.G.A. § 48-7-28.3 does not apply to the portion of related member costs that the taxpayer establishes by a preponderance of the evidence that the related member during the same taxable year directly or indirectly paid, accrued, or incurred to a person that is not a related member and the transaction giving rise to the related member costs has a valid business purpose.

(b) When a taxpayer seeks to claim the exception provided by subsection (f) of O.C.G.A. § 48-7-28.3, the taxpayer must provide

the following information on the Form IT-Addback (with all supporting documentation to be made available upon request or upon audit):

1. The name and federal identification number of the related member and the name of the unrelated party to whom the related member paid the related member costs for the same intangible property licensed to the taxpayer;

2. A description of the business purpose of the transactions between the taxpayer and the related member and between the related member and the unrelated party. The following shall apply with respect to such description:

(i) The taxpayer's and related member's business purpose or purposes for their transactions must be stated in specific terms and not in the abstract. Also, the purpose or purposes stated should relate to the particular transactions for which the deduction is being claimed and not, for example, to the formation of the related member entity that takes part in the transaction. Further, the taxpayer's and related member's business purpose or purposes should be related to business activity that is conducted by the taxpayer and related member or business activity that the taxpayer and related member are planning to conduct;

(ii) The taxpayer must identify each of the elements of the transaction that it relies upon to support a finding that the activity or transaction changes in a meaningful way, apart from the tax effects, the economic position of the taxpayer and related member. If the taxpayer and related member entered into the transaction on the advice of a tax advisor, or the terms of the engagement with a tax advisor determined the fee paid directly or indirectly to the advisor by reference to the actual or anticipated tax savings derived from the transaction, the taxpayer must disclose such fact(s); and

(iii) A statement as to whether the payments were made pursuant to one or more written agreements and if so a brief description of each agreement. Further, the taxpayer and related member must state how the taxpayer and related member actually used the intangible property in question;

3. The amount of related member costs paid by the taxpayer to the related member and the related member costs paid by the related member to the unrelated party. If the two sets of payments are not identical in kind or amount or in any other respect the taxpayer must explain the basis for the discrepancy; and

4. Such other information as the Commissioner may prescribe.

Authority: O.C.G.A. §§ 48-2-12 and 48-7-28.3.